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In the Supreme Court of the United States

OCTOBER TERM, 1980

KEMLON PRODUCTS AND DEVELOPMENT COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENTS IN OPPOSITION

REX E. LEE
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 633-2217

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Petitioners seek review of the decision below holding that their action, which seeks to enjoin the Internal Revenue Service from disclosing tax return information of petitioner Kemlon Products and Development Company (Kemlon) to any of its business customers, is barred by the Anti-Injunction Act, 26 U.S.C. (& Supp. III) 7421(a).

The pertinent facts may be summarized as follows: Kemlon and Keystone Engineering Company are engaged in the research, development, manufacturing and sale of certain patented products for use in the oil and gas industry. In December 1976, the Internal Revenue Service initiated an audit of the corporation's tax returns for their taxable year ended September 30, 1975. In the course of examining Kemlon's tax returns, the Service questioned the accuracy of depreciation deductions claimed with respect to a certain

patent held by Kemlon in connection with the production of a ceramic electrical conductor. In particular, the Service questioned whether a portion of the value assigned to a patent by Kemlon should have been allocated to other assets, such as goodwill. The Service was also concerned about the useful life of the patent. Kemlon provided the Service with all information requested concerning the patent (Pet. App. A-3).

The agent in charge of valuing the patent, Engineering Agent Gary D. B. Brown, concluded that it would be necessary to meet with customers of Kemlon in order to obtain information concerning the products, the customers' use of the products and their dealings with Kemlon. Counsel for Kemlon objected that the Service's questioning of Kemlon's customers would disrupt its confidential business relationships and would constitute unauthorized disclosure of tax return information in violation of Section 6103(k)(6) of the Internal Revenue Code of 1954 (26 U.S.C.). Kemlon's counsel offered to obtain the desired information from third parties or, alternatively, to arrange a meeting with the customers if Agent Brown would furnish in advance the questions to be asked. Agent Brown consulted with other Service officials, who determined (a) that the valuation of the patents required an interview with Kemlon's major customer and (b) that such an interview would not violate Section 6103 (Pet. App. A-3, A-4).

Kemlon and the other petitioners commenced this suit in the United States District Court for the Southern District of Texas, seeking to enjoin Agent Brown and the Service from disclosing directly or indirectly Kemlon's return information to Kemlon's customers. Kemlon claimed that such an injunction did not come within the bar of the Anti-Injunction Act and that disclosure of the return information would violate Section 6103(k)(6) of the Code, the Privacy Act of 1974, 5 U.S.C. 552a(b), and, in addition,

Kemlon's constitutional right to privacy. Kemlon alleged that disclosure of the fact that Kemlon was being audited would cause substantial and irreparable harm for which no adequate remedy existed at law, *i.e.*, a loss of business reputation and the opportunity for Kemlon to work on new and other patentable products (Pet. App. A-5, A-15). In support of this allegation, Kemlon submitted the affidavit of petitioner John H. Ring, a shareholder. The affidavit did not, however, elaborate on how the purported harm would come about (Pet. App. A-5).

The district court granted Kemlon's request for an injunction. Although it held that the action was within the scope of the Anti-Injunction Act, it concluded that petitioner satisfied the two conditions of the exception to the Act established by *Enochs* v. *Williams Packing & Navigation Co.*, 370 U.S. 1 (1962), *i.e.*, where a taxpayer demonstrates (1) that irreparable harm otherwise will occur and (2) that the government cannot possibly prevail on the merits of the underlying controversy. Noting that Kemlon had made a " 'substantial claim of irreparable injury,' " the court ordered the Service, on the authority of *Commissioner* v. *Shapiro*, 424 U.S. 614 (1976), to submit to Kemlon the questions it intended to ask its customers in order that Kemlon could have an opportunity under *Williams Packing* to prove that it might prevail on its Section 6103 claim. The Service declined to give the questions to Kemlon but submitted them to the district court, sealed for in camera inspection, after requesting that the court either certify its order for appeal or, alternatively, issue an injunction which could be appealed. The court thereupon issued an injunction barring the Service from disclosing return information to Kemlon's business customers (Pet. App. A-6 to A-9).

The court of appeals reversed. It held that Kemlon failed to demonstrate irreparable harm merely by its conclusory allegation that it would lose customers as a result of disclosure of the fact that it was under audit. The court further stated that even assuming arguendo that Kemlon met its burden of proving irreparable harm, the government had at all events come forward with basic facts to show that it may prevail on Kemlon's Section 6103(k)(6) claim (Pet. App. A-2, A-16 to A-18).

1. Petitioners do not even allege any error in the court of appeals' holding that Kemlon failed as a matter of law to meet its burden of proving irreparable harm as required by *Williams Packing*. That ruling disposes of petitioner's claim for injunctive relief. Indeed, the court of appeals found that Kemlon's claim in this regard was frivolous. As it stated, "[t]o describe Kemlon's allegation of irreparable harm is to decide this case" (Pet. App. A-15). As we have noted, Kemlon alleged essentially that disclosure of the fact that it was under audit would cause it to lose customers because of concern for its financial stability. But as the court of appeals observed: "It in no way alleged or proved facts indicating how its customers would infer financial instability from knowledge of an audit. It in no way alleged or proved facts showing how disclosure of an examination into the value of its patents would indicate financial instability" (Pet. App. A-16).

2. Petitioners further contend (Pet. 8-13) that the court of appeals erred in its alternative holding that the government in any event had satisfied the requirement of *Commissioner* v. *Shapiro, supra*, to show that it might prevail on Kemlon's Section 6103(k)(6) claim. But absent a showing that petitioner would suffer irreparable injury, its argument in this regard is immaterial. At all events, petitioners err in contending that *Shapiro* and *Phillips* v. *Commissioner*, 283 U.S. 589 (1931), require the government to demonstrate

something more than that it might ultimately prevail on the merits. *Phillips* upheld the validity of a summary tax collection procedure in issue there. And *Shapiro* plainly held only that, assuming a preliminary showing of irreparable harm to the taxpayer, the government must disclose basic facts from which it appears that the Government may prevail (424 U.S. at 627-628). And petitioners do not dispute the court of appeals' conclusion that the government made such a showing here.

3. Finally, petitioners contend (Pet. 13-16) that a taxpayer has a constitutional privacy interest in preventing disclosure of the fact that it is being audited. But apart from the fact that petitioners did not so argue before the court of appeals, they can hardly claim that the government violated such a right because the disclosure of that fact was occasioned by their commencement of this very suit.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

REX E. LEE
Solicitor General

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